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## PRESENT PROBLEMS IN CANADIAN BANKING

It may fairly be said that the recent revision of the Canadian bank act has tended to conserve sound principles in banking. Sometimes, in a democracy, the power of legislation falls into the hands of politicians who confessedly pay no attention to the work of experts, but judge a measure by its power to gain votes. Fortunately for Canada the act was piloted through committee and Parliament by a finance minister who has had wide experience in the world of finance, and who did not hesitate to call in counsel such experts as Mr. Forgan of Chicago, Sir Edmund Walker of Toronto, and Mr. Pease of Montreal, as well as many other financiers of wide training and experience. Although the measure was bitterly assailed in the House of Commons by "cheap money" advocates, it became law without the incorporation of many ill-considered amendments which were proposed during the debate. In a previous number of the *REVIEW*<sup>1</sup> the changes in connection with note issues and inspection were considered. It is proposed in this article, therefore, to deal with several pressing problems that have arisen in Canadian banking during the past few years, but which have received scarcely adequate attention owing to the almost exclusive interest shown in the questions of note issue and inspection.

It is a common charge against the banks that they are making excessive profits, and that the public is paying too much to have its banking business done. Particularly is this charge made in the West, with the result that active measures—which will shortly be described—are being taken there to provide cheaper money for farmers. To a certain extent the banks themselves are to blame for the spread of this opinion. It is only natural, perhaps, that they have boasted of their prosperity, especially when seeking to attract new capital. From a casual glance at the balance sheet of any Canadian bank it would appear, too, that they are making large profits. The net profits of the Canadian Bank of Commerce for 1912, for example, amounted to \$2,800,000 on a capital of \$15,000,000. This is somewhat more than 18 per cent on the capital; but if the surplus also is included the profits must then be computed on \$27,500,000, which would work out to a little over 10 per cent. Indeed, the only fair method of estimating the rate of profits is to include with the capital the surplus or rest fund.

<sup>1</sup> Volume III, no. 4 (December, 1913).

Sir Edmund Walker, president of the Canadian Bank of Commerce, is not content, however, with that statement of the case. In an attempt to show that banks were not making excessive profits, as compared with other corporations, he had prepared one hundred balance sheets of corporations that are in close business relations with the Bank of Commerce. The statements covered the earnings of corporations in 49 different industries, ranging from cracker factories to coal mines and representing a capital investment of \$76,000,000. These concerns were of average, normal prosperity, and were not hand-picked to prove a special point. In each case it was found that the profits earned were higher than the average secured by the banks, although in some instances they were approximately the same. Sir Edmund Walker's analysis of banking profits showed further that the earnings of all Canadian banks, on their combined capital and surplus, would average a little more than 9 per cent. The percentage of the dividends on the market price of the stock is between 5 and  $5\frac{1}{2}$  per cent.

The matter may be considered also from another standpoint. The profits earned on the entire assets which are controlled by the banks amount to only 1.20 per cent; and, in the case of individual banks, range all the way from .93 to 1.59 per cent. If it be granted that the capital and surplus of a bank could earn 6 per cent in any other investment business, then it follows that the profits earned on the other assets which are controlled by a bank, by virtue of the peculiar features of the banking business, would average only about .25 or .30 per cent. That is to say, banks make a little more than one quarter of one per cent on the assets they control outside of their own capital. These facts are presented in Table 1 on the following page—"capital" including ordinary capital, surplus, and undivided profits.

In face of the facts presented it cannot justly be said that the banks are making excessive profits. Indeed, the profits are not at present such as to attract any great volume of capital into the banking field, through the formation of new banks. What Canada needs more than anything else just now is more capital; and the federal government, as well as the provincial legislatures, would be well advised in refraining from passing legislation that would in any way curtail the growth and usefulness of the banks of the country.

The Canadian West thinks it has a real grievance against the banks in respect to the difficulty of securing loans, and espe-

TABLE 1

Banks	Profit on entire assets	Deduct 6 per cent and profits are	Earnings on capital	Earnings on market value of stock	Dividends (1912) on market price of stock
Commerce	1.14	.45	10.15	8.64	5.07
Dominion	1.14	.25	7.84	7.77	6.03
Hamilton	1.01	.18	7.41	8.10	5.39
Hochelaga	1.57	.41	7.98	9.61	4.49
Imperial	1.36	.30	7.83	7.37	5.29
Metropolitan	1.23	.18	7.07	8.48	5.03
Montreal	1.06	.23	7.44	6.35	4.84
Merchants	1.59	.64	10.13	10.02	5.05
Molson	1.29	.30	7.76	8.27	5.31
Nationale	1.35	.39	8.53	11.84	5.65
Nova Scotia	1.36	.22	7.18	7.40	5.05
Ottawa	1.26	.26	7.74	8.01	5.62
Quebec	1.33	.30	7.82	8.93	5.30
Royal	.93	.10	6.19	6.41	5.33
Standard	1.12	.29	6.22	8.06	5.51
Toronto	1.41	.27	7.56	8.00	5.74
Union	1.02	.29	8.44	9.26	5.30

cially in connection with the interest charged. The act permits banks to charge 7 per cent on loans; and no higher rate is recoverable at law. As a matter of fact, however, interest rates on bank loans in the West range all the way from 8 to 12 per cent, and in some instances, on small amounts, the rate is higher. Some banks have charged as much as \$1 a month on a loan of \$25. It has been estimated, however, that it costs, on the average, 2 per cent more to carry on the business of banking in the West than in the East. This is due to the fact that salaries, rents, etc., are much higher in the West, and the risks incurred are greater. Bankers insist that if the legal interest rate were enforced the majority of bank branches in the West would have to be closed.

Mortgage loan companies receive, on loans running for a period of years, a rate ranging from 8 to 9 per cent; and the preliminary expenses entailed make the loan  $1\frac{1}{2}$  to 2 per cent higher. Implement dealers charge 12 per cent on notes; and, when it is remembered that implements sold on credit bring high prices, it can readily be understood that the farmer pays a very high price for his tools and machinery—and, in fact, for all supplies bought on a credit basis. A review of the whole situation shows that the banks should not be singled out for criticism. Indeed, the fundamental credit problem in the West is concerned with cheaper money for farm loans—a matter that touches the mortgage com-

panies and not the banks, for the latter institutions are prevented by law from making loans directly on farm mortgages.

During the summer of 1913 several members of a commission, appointed by the government of Saskatchewan, toured Europe in search of practical suggestions for establishing a system of rural coöperative credit in that province. As a result of their investigations, both in Europe and within the province itself, a plan was formulated, and presented to the government, providing for the creation of land mortgage associations in Saskatchewan on the model of the *Landschaften* of Germany. Without meeting any serious opposition in the legislature, the Saskatchewan Coöperative Land Mortgage Association Act was passed, which embodies the main suggestions of the commission. As yet, however, nothing has been done toward putting the scheme into practical operation.

Before outlining the main features of the proposed mortgage associations, it will be well to present the net results secured in the investigation of local conditions in the province. The commissioners conferred with bankers, farmers, ranchers, and business men at many important centers; and endeavored to get first-hand information on crucial points. The results of their investigation, gathered from the voluminous mass of material secured, may be summarized as follows:

TABLE 2

District visited	Is district prosperous?	Per cent of land mortgaged	Is it difficult to get loans	Average rate of interest	Are farmers willing to coöperate?
Weyburn	Yes	50-60	No	9-14	Yes
Oxbow	Yes	50	No	8, 9, 10	If aided, yes
Swift Current	Yes	75	Yes, very	8, 9	Yes
Moose Jaw	Yes	90	Yes, very	8	Yes
Wolseley	Yes	90	Yes, very	7, 8, 8½	Yes, if aided
Fillmore	Fairly so	99	Yes	9	No
Saskatoon	Yes	90	Yes	8-10	Yes, if aided
Govan	No	90	Yes, this y'r	8, 9, 10	Yes
Scott	No	95-100	Impossible	9	Yes, very
Melville	No	60-90	Impossible	8, 9, 10	No
Yorkton	No	No return	Yes, very	9-10	Yes, if aided
Prince Albert	Yes	20-60	Yes, very	8-10	Yes
Melfort	Yes	70-90	Difficult	8, 9, 10	Yes
N. Battleford	Yes	90	Yes	9	Yes, if aided
Regina	Fairly so	60-90	Yes, very	8	Yes, very

The following interesting facts are made clear by this investigation: (1) It is in the more prosperous districts that the farmers are willing to form credit associations; in other places some form

of government aid has been sought. (2) On the whole there is a well-defined demand throughout the province for some form of credit association that will supply cheaper capital to the farmer. (3) It is surprising to note, too, the extent to which land is mortgaged in the West—in some districts practically every farm is encumbered. (4) And finally, interest rates on mortgage loans are very high, in comparison with rates charged in the East.

The plan presented by the commissioners to the government may be thus outlined. Legislation shall be enacted to provide for the establishment of a coöperative mortgage association for the raising of funds on mortgage bonds, and the granting of loans to farmers on mortgage security for approved agricultural productive improvements only. The organization shall consist of an executive committee of at least three members, to be appointed by the government; and an advisory board of fifteen members, to be appointed in part by the association acting through its annual general meeting, and in part by such organizations in the province as exist to promote agricultural betterment. The conditions of membership of local associations are as follows:

(1) The individual members are to be borrowers, admitted by vote of the local association, and approved by the central commission. An entrance fee of \$10 will be charged.

(2) Each local association shall consist of at least ten members with a combined mortgage loan of at least \$5,000, united on the basis of joint and several liability. The liability, however, shall be limited to an amount not greater than 50 per cent of the loan granted to each member.

(3) The liability of the several local associations to the parent body shall be in the proportion that the aggregates of the mortgage loans of the local associations bear to the whole.

(4) All mortgage loans shall be issued on an amortization basis to cover a period of not less than fifteen, and not more than thirty-five years; with the option given the borrower, upon three months' notice or a bonus of three months' interest paid, of paying the whole or any part of the balance due in excess of the stipulated payment on any regular day of payment before the final payment.

(5) The funds required by the association, for loans to its members, shall be raised on mortgage bonds issued by the association, and fully guaranteed by the provincial government; the amount of such government guaranteed bonds to be determined annually by agreement between the provincial government and the association.

(6) The loans shall be limited to 40 per cent of the central commission's valuation of the property to be mortgaged.

(7) The association shall advance its funds to borrowers at a rate of interest which shall include only the cost to the association of the money itself, the expenses of administration, and provision for the

creation of a reserve fund to provide such security and guarantee for the future issue of mortgage bonds as will in the course of time render government guarantees unnecessary, and place the association on a purely self-supporting basis.

(8) The association shall establish, as soon after its foundation as is feasible, a bank with headquarters within the province, to conduct a regular banking business, both through branches of its own and, wherever possible, with and through the locals of the association. It is expected that assistance will be rendered by the provincial government, at the time of the establishment of the bank, so that the association will be able to control it in the interests of agricultural industry.

As might be expected, the plan has been subjected to much adverse criticism, especially in the East; but something may reasonably be expected from it. It should be noted that the money is not to be raised on the credit of the province alone; it is specifically recommended that the funds shall be raised on mortgage bonds issued by the association. Bonds based on first mortgages, for loans not exceeding 40 per cent of the value of the farms, will have sufficient security independent of the government guarantee. If not, what security is behind the \$65,000,000 already loaned in the province by private mortgage companies? Moreover, the provincial guarantee itself is worth something simply because the legislature has power to tax those same lands, as Saskatchewan is an essentially agricultural province. The government guarantee should certainly enable the mortgage association to float its bonds in the London market at a fair rate of interest—considerably lower than what is charged at present by land mortgage companies.

The measure has been attacked on the ground that it makes the local associations of ten members jointly and severally liable for mortgage loans. It is said that, under these conditions, the businesslike, progressive farmer will have to share any loss arising from the inefficiency of others. But it should be observed that the liability assumed, in each case, is not an unlimited one, being no greater than 50 per cent of the farmer's loan; and, in the second place, seeing that the members of a local group are to approve each other, and that the group is to be formed by mutual consent, the progressive members have every opportunity to exclude undesirables.

It has been contended that coöperative mortgage associations have been successful only where there is a large lending, as well as a large borrowing, class. While this is usually the case, there are exceptions. Danish land mortgage bonds, for instance, are issued in Berlin at the same time as in Copenhagen, and they find

a ready market in Germany. Many European governments, too, grant substantial assistance to rural coöperative credit societies, in some instances guaranteeing their bonds. These features of the problem, however, are so well known that it is not necessary to dwell upon them.

The proposal to establish a bank to take care of the business of the mortgage associations is a question which should receive very careful consideration before the project is put into effect. At present the chartered banks have a network of branches spread throughout the prairie provinces. They have gone into towns and villages where there was no possibility of profits for several years; but they have been content to wait. They have afforded an abundance of credit in the past; and it is difficult to see wherein a farmers' organization could more effectively serve the community. Moreover, it should be borne in mind that a bank cannot begin business in Canada with a subscribed capital less than \$500,000, of which at least \$250,000 must be paid up. It appears, however, that the mortgage associations expect the government to aid them in starting the institution. In that case, not only must the government assume double liability for all the stock it will hold, but it must be responsible also, at least in part, for directing the general banking policy of the institution. If the government should decide to take stock in the bank, it will be the first time in Canada's history that a government has interfered in such business. The dangers inherent in such a situation need not be dwelt upon.

The specific charges made against the chartered banks, in their relations with the farmers, are as follows:

(1) They have frequently sought to dominate the policy of those businesses to which they have advanced credit.

(2) They have sought rather to pay dividends, and to support expensive offices, than to afford credit to customers at reasonable rates.

(3) They are not controlled within the province (Saskatchewan), and in a time of stress when credit facilities are most required the banks withdraw them from the western provinces.

(4) Their charges for transferring funds are unreasonably high.

(5) The rate of interest on loans is unreasonably large.

(6) The interest allowed on deposits, 3 per cent, is too low.

(7) Their sympathies lie rather with the commercial, than with the agricultural, class.

To these charges the bankers give an emphatic denial. They maintain that credit has been granted, if anything, too freely in the West; and that the farmers have not, in turn, sufficiently con-

sidered the needs of the banks. Experience goes to show that when crops are sold implement dealers are first paid; then interest and principal on mortgages are met; and after that, merchants' accounts are settled. The bank is paid last, because farmers appear to think that these institutions are not in need of the money. In a word, bankers insist that they have dealt far more liberally with the West than the critics and farmers in the prairie provinces have dealt with them. A prominent banker has stated:

With regard to the complaints made against the banks, that they have sought to dominate the policy of those borrowing from them, bankers have always considered that it was part of their duty to act as counsellors to their customers; and that when a man has gone out of his way in investing money, while he is still a borrower, it is the duty of his banker to remonstrate with him. Moreover, records show that the banks have not withdrawn credit facilities from the Western provinces. That the sympathies of the banks lie rather with the commercial than with the agricultural class, is an absolutely erroneous statement. Bank directors and the head officers recognize that they have a duty to all classes of the community; and they endeavor to fulfil it, as nearly as may be, to the best of their ability.

Canadian banks have been for many years in the foreign field; and they are yearly extending their business abroad. American banks have hitherto been unable to secure a share of this business; but it may be expected that under the Glass currency act they will establish branches abroad. Of course there are difficulties to be faced, the chief of which are that in the most promising fields—Central and South America—London is favored as a clearing center. In these countries New York counts to only a small degree. The denominations used in exchange transactions are in sterling, English money, and it would not be possible to do business except through that medium. This factor may appear to be a small one, because American banks have men trained to do business in pounds and shillings; and they could certainly conduct business in that currency. The real point, however, is that the banks already established are not only accustomed to doing their entire business through London, but they have been on the ground so long that they have an established clientele, and it would be hard work getting business away from them.

Canadian banks, as has been said, have been in the field for years. At the end of 1912 they had thirteen branches in Newfoundland, and sixty-two branches elsewhere—principally in the United States, Mexico, Cuba, and the West Indies. This has been of great benefit in extending Canada's foreign trade. This

development in Canadian banking, however, has not been free from attack. It is charged that Canadian capital has been withdrawn from the country for foreign investment; and some advocate that such bank funds as are employed abroad should be taxed. An attempt was made during the revision of the bank act in 1913 to so tax banks doing business outside of Canada; but the suggestion was voted down. Nothing, indeed, could be gained from such a procedure; for the business that the banks carry on abroad is to the direct advantage of Canada. The Royal Bank went into Cuba in 1899, and now has nineteen branches there. In 1901 Canada's imports from Cuba amounted to \$343,374, and her exports to \$578,013. The corresponding figures in 1912 were \$1,770,874 and \$2,096,778 respectively. While, of course, Canadian banks cannot be credited directly with this gain, they have nevertheless done important work in building up this trade.

Moreover, Canadian banking abroad has not been fostered chiefly by Canadian capital. On the contrary, deposits in bank branches in Cuba and the West Indies are in excess of the loans made. It will thus be seen that it is to the entire advantage of Canada to encourage the establishment of branches of banks in Central and South America and in the West Indies. It is estimated that \$200,000,000 of American capital has been invested in Cuba alone; but it is Canadian banks that have profited by the consequent growth of trade. In no way does this foreign business work to the detriment of Canada. Canadian branch banks in Cuba and the West Indies have money on call in New York; and, if necessary, it could be made available in a period of financial pressure in Canada. In a word, the business has been most profitable for Canada and her banks; so much so that an American syndicate offered the Royal Bank \$1,000,000 for its good-will in the West Indies, if that bank would retire from the Islands. The investment of Canadian capital in various enterprises in Mexico and South America, which has been so bitterly criticised of late in Canada, is an entirely different matter. The very great decline during 1913 in the securities of Mexican and South American corporations, engineered and financed by Canadians, may seem to prove that the more stable conditions in this country make Canada a more profitable field, in the long run, for investment. But that is an entirely private matter, and a subject quite distinct from the extension of Canadian banking abroad.

The opinion has been industriously spread by the radical ele-

ment in Canada that the banks form a huge "money trust," and are working together for the exploitation of the country. It is maintained that the process has been furthered by recent bank amalgamations. This problem occupied a good deal of attention during the last revision of the act, and is therefore worth considering.

It is perfectly true, of course, that the Canadian banking system is made up of institutions of relatively large capital. That is seen by a glance at the following table, which shows the amount of capital and surplus of the leading banks.

TABLE 3

Bank	Capital	Rest or surplus
Montreal .....	\$16,000,000	\$16,000,000
Commerce .....	15,000,000	12,500,000
Royal .....	11,560,000	12,560,000
Imperial .....	6,809,134	7,000,000
Nova Scotia .....	5,957,320	10,830,248
Dominion .....	5,356,227	6,356,227
Toronto .....	5,000,000	6,000,000

That the tendency in recent years has been to reduce the number of banks and to decrease their size cannot be disputed. In several cases the size of the bank has been increased by amalgamating with it weaker institutions. Most bankers agree that it is a good thing to remove a weak bank by merging it into a stronger one. They have not hesitated to put their theories into practice. The Bank of Montreal has absorbed three; the Canadian Bank of Commerce, four; the Bank of Nova Scotia, two; and the Royal Bank, two. These consolidations have been formed with the object, also, of securing a strong chain of banks throughout the whole country. For example, in the recent merger of the Traders Bank and the Royal Bank, the former had branches confined for the most part to Ontario and the Middle West, while the Royal was strongly represented in the Maritime Provinces and on the Pacific Coast. The union of these banks formed an institution with branches widely scattered throughout the length and breadth of Canada. The branches were duplicated at fifteen points only; but as many of these points are commercial centers, already well supplied with banks, it is hardly possible that competition will be lessened by the union of these two institutions.

Now, in spite of the criticism aroused by these mergers, it is noteworthy that the Canadian banks have expanded in all directions in recent years. This applies not only to the increase of their

capital, but to the increased facilities for banking offered to the people. This extension of banking has been due to the rapid development of the country, and to the large capital investments that have been made. The number of new branches that have been established in all directions is certainly remarkable; and the majority of these branches have quickly justified themselves.

But, so far from its being true that the banks have formed any sort of trust, many parts of the Dominion seem to have even an excess of banking accommodation. The banks themselves have felt the pressure of this competition and are not rushing into new territory as they did a year or two ago. It is desirable that banks, before branching out, should thoroughly satisfy themselves of the need of additional banking facilities in the new districts; otherwise, as has been said, undue competition is the result. This raises discount rates in the end, and causes the banks to undertake undesirable business. The danger at the present time lies in the undue multiplication of branch banks, rather than the reverse. If the banks, especially in the West, would work more in harmony with one another, more reasonable banking rates and facilities for customers might result.

In order that the public interests may be safeguarded, however, the act of 1913 provides that no agreement by a bank to sell the whole or any portion of its assets to another bank, can be made until the minister of finance first gives his consent. Mr. McLeod, late general manager of the Bank of Nova Scotia, as well as several other critics, maintained that the assent of Parliament to a proposed merger should also be secured; but the precautions taken would seem to be sufficient. Making the matter public, with discussion in Parliament, would manifestly prejudice the position of the bank selling out its interests. An attempt would be made at once by the other banks to get part of its business; and it would then be extremely doubtful whether the agreement could be put through. And there might be good reasons why it ought to be put through. If a bank gets into a bad position, it is sometimes necessary that it should be absorbed by some other bank, thus saving the public from the shock to business that would arise from a bank failure. This point should not be overlooked; for it is important in considering the question of consolidation.

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